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SUBJECT: UN ADMINISTRATION: PENSION BOARD APPROVES INVESTMENTS PLAN AND APPOINTS AN AUDIT COMMITTEE

The following is a summary of the meeting of the Board of the UN Joint Staff Pension Fund, recently held in Nairobi. It was prepared by Thomas Repasch, USUN Minister-Counselor who was appointed by the General Assembly to serve as an alternate member of the Board.

¶1. Summary. At its meeting held in Nairobi July 13-21, the 33-member Board of the UN Joint Staff Pension Fund considered several dozen reports on a range of topics, including: the Fund's actuarial valuation; management of the Fund's $32 billion of investments; and the creation of an Audit Committee to improve governance. The meeting, chaired ably by Mr. Vladimir Yossifov, a Participant member of the ILO Pension Committee, was held on the beautifully landscaped UN Headquarters complex located in the hills overlooking the Kenyan capital. In a departure from its usual practice of consensus decision making, Board members decided by a vote of 17 to 11 (with one abstention) to approve the proposal made by the Secretary-General to manage the Fund's $8 billion in North American Equities in a passive way by outsourcing the portfolio, eliminating the need for the UN to maintain a staff of managers for these investments. The two groups representing the UN Executive Heads and the Governing Bodies voted for the investments plan, while the third group of the tri-partite Board, representing the Participants, dismissed the plan as premature and risky. Although the investment plan had full backing from the prestigious Investments Committee (chaired by William McDonough, former chairman of the Federal Reserve Bank of New York), some members criticized the presentations made by Under-Secretary-General for Management Chris Burnham and his chief of investments, Cheiko Okuda, as vague and not convincing.

¶2. In another move, the Board decided to use part of the Fund's 1.29 percent actuarial surplus to restore some benefits that were reduced several years ago when the Fund experienced financial difficulties. It also rejected a working group recommendation to reduce the Board's membership to 21 but approved a measure to change the frequency of its meetings from every two years to annually in order to improve governance. The Board rejected a proposal from the ILO and retirees to expand the use of the Emergency Fund but decided to keep another benefit proposal alive by directing the Fund's CEO to visit Ecuador to collect information about the plight of UN pensioners who claim they were disadvantaged when their country was "dollarized" several years ago. As part of its consideration of the Fund's budget, the Board approved supplemental appropriations to: bolster staff of the Investments Management Service; strengthen internal and external audit capabilities; provide for travel for members of the new Audit Committee; and upgrade positions in the Fund's information technology office. At the same time it rejected requests for more office space and for consulting services to help in pursuing socially responsible investments.

¶3. The Pension Board's report, which has been sent

electronically to the Department (IO/S; Podolsky and Glockner) will be issued as a UN document in the coming weeks in advance of its consideration by the Fifth Committee during this autumn's session. The Board decided to meet on an annual basis and will meet next year in New York; it accepted an invitation from the International Fund for Agricultural Development (IFAD) to meet in Rome in 2008. The following paragraphs provide details of the Board's deliberations on selected items. Suggestions for the U.S. to consider in formulating its position on the Pension Board report are also included where applicable. End summary.

¶4. Management of investments - This issue was by far the most contentious item, producing a rare vote by a body that works hard to produce consensus agreements. The main issue was the Secretary-General's proposal to "outsource" the Fund's investments in North American Equities. Although the Fund had experienced significant asset increases in recent years and had achieved actuarial surpluses, the Representative of the Secretary-General (Mr. Burnham) had stated in several briefings over the last several months that the Fund was "under-performing". He also suggested that the UN should give its investment management business to consultants and advisors. These remarks created concerns particularly among the Participants' Group, causing the Secretary-General to write to UN staff on July 11, telling

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them that there was "absolutely no plan or proposal for 'privatizing' the Pension Fund or changing the system of benefits." The controversy carried over to Nairobi, where the Fund's Investments Committee met just before Board's meeting and discussed the proposals. The word circulating among some Board members was that the Investments Committee, headed by former NY Federal Reserve Chairman William McDonough, had a very heated exchange with Burnham about the performance of investments. Rather than conclude that the Fund had been "under-performing", the Committee pronounced

that the North American Equities portfolio had not kept pace with market indexes.

Determining that it would be impossible for the UN's investment managers to try to beat the indexes of the world's "most efficient investment marketplace," the Investments Committee endorsed the plan to manage this portion of the Fund's investments in a passive way, hiring a firm to produce returns equal to the indexes. While Burnham claimed that this approach would eventually save the Fund money, the proposal carried immediate financial implications of $2.9 million to pay for transition services and the costs of indexed management.

Despite efforts to allay the concerns of the Participants, the Group opposed the proposals from the very beginning of the meeting. At one point they went so far as to propose that the responsibility for investments be taken away from the Secretary-General and given to the Chief Executive Officer of the Pension Fund. One leader of the Participants Group said repeatedly that the outsourcing plan was risky and premature since the Board had not yet received the results of the Asset/Liability Management Study that it had approved previously. Many members of the Board (including me) found it difficult to distinguish between among proposals to improve the management of the beleaguered Investment Management Service and those aimed at improving investment returns. Although they have no formal role in the Board's decision-making, representatives of the retirees joined with the Participants in opposing most proposals.

The drama heightened as the Board plowed through its hefty stack of reports and narrowed its focus to the investment management issues. With no compromise in sight, the Board suspended its meeting and awaited the outcome of a "working group" commissioned to produce an agreement. The working group met for several hours, producing a tentative agreement that would express concerns but would also approve the

investments plan and most of the requested budget increases. (Comment: I was a member of this Group, representing the Governing Bodies group). When the Participants' representatives took the compromise back to their Group, the proposal was rejected, setting the stage for a vote that the Participants knew they would lose. The Participants remained defiant in their loss, as other Board members (including me) saw the vote as a referendum on the performance of Under-Secretary-General Burnham. Some Board members who voted for the plan (including me) privately expressed disappointment at the style and approach used by Burnham; many also agreed that Burnham's Director of Investments, Ms. Cheiko Okuda, while hard-working, was not up to the task of managing the Fund's $30 billion-plus in investments.

Comment: When the report is considered by the Fifth Committee this autumn, the U.S. might want to express concern about the Board's use of voting for this decision and seek information on progress made by the Secretariat in implementing the investments plan.

¶5. Actuarial Valuation - The Board was told by its actuaries that the Pension Fund had completed 2005 showing a surplus of 1.29 percent. This means that the value of the Fund was 1.29 percent more than the amount needed to pay all of its promised benefits, based on the standard assumptions and actuarial models. The Board was informed that the surplus was primarily the result of gains from the continuing moderate levels of inflation and changes in the participant growth assumptions. The surplus was slightly higher than the 1.14 percent shown during the last valuation in 2003 and represented the fifth consecutive valuation that had resulted in a surplus.

Because the Fund showed a surplus, there immediately ensued discussions on what to do with it. Representatives of the Participants proposed to restore all the benefit reductions imposed in the 1990's when the Fund fell on hard times. Another proposal made by the ILO Pension Committee was to spend some of the money to expand the use of the Emergency Fund to help former UN staff members from the Soviet Union who were cheated out of benefits promised them by their former Communist governments. Still another idea was to help retirees in Ecuador who were "economically disadvantaged" when their country dollarized its economy several years ago. The Board decided to spend about .32 percent of the surplus for partial restoration of reduction in the first consumer price index adjustment and elimination of the limitation on the right to restoration for existing and future contributing participants based on length of prior service. With this decision, there will remain a small portion (.5 percent) of the consumer price index reduction still in place. The General Assembly, in its resolution from 2004, pronounced that it would not consider approving any other benefit improvements until the reductions were fully restored.

Comment: Even though the Board's decision on the surplus was a generally conservative one, the U.S. may still want to ask why the Board allowed the Fund to dip below the one percent surplus level (to .97 percent) considered prudent by most actuarial experts. The U.S. might also want to oppose the Board's decision to send the Fund's Chief Executive Officer to Quito to find out more about the plight of the UN retirees in Ecuador. Such a trip would clearly be a waste of the Fund's resources since the General Assembly has already decided that it would not approve any benefit improvements until benefit reductions were fully restored.

¶6. Audit Committee - The Board decided to create an Audit Committee and approved Terms of Reference that provides for up to nine members, including two "outside experts", one member to represent retirees, and two members from each of the three groups that comprise the Board. Using the criteria aimed at obtaining experts in audit, financial management, or compliance, the groups proposed and the Board appointed the following members for 4-year terms. They Committee is

expected to meet twice each year, once in New York and once in Geneva.

Executive Heads: K. Matsuura (UN-Geneva); G. Engida (UNESCO-Paris)
Participants: J.B. McGhie (IFAD-Rome); C. Santos Tejada (UNGeneva)
Governing Bodies: J. LaRiviere (WHO-Geneva); T. Repasch (UN-New York)

Comment: The U.S. may want to commend the Board for creating the Audit Committee and express hope that the Committee will be able to help the Board grapple with oversight, accountability, and governance questions. At the same time, the U.S. might want to ask how the Board has assured itself that the Audit Committee members are indeed "experts" in the appropriate fields and find out, in particular, whether all Committee members have circulated their resumes among Board members.

¶7. Size and composition of the Pension Board - The Board rejected the preferred recommendation of its longstanding Working Group to reduce the size of the Board from 33 members to 21. In doing so, the Board recognized that its decision did not respond to requests from the General Assembly to reallocate the seats on the Board in order to provide more equitable representation of the participating organizations. In particular, the General Assembly and the UN Secretariat have had long-term concerns that the UN, with up to 70 percent of the participants and/or beneficiaries in the Fund, has only 36 percent of the members of the Board. The 21-member proposal would have increased the UN's representation to more than 40 percent. The Board did, however, adopt a number of other measures to improve its efficiency and (hopefully) improve the overall quality of governance. Perhaps most importantly, the Board decided to meet annually beginning in 2007, thus reducing the role of the Board's 15-member Standing Committee, which had met in odd-numbered years to consider the Fund's proposed budget. Henceforth the Standing Committee will deal primarily with appeals cases. While deciding to retain its tri-partite structure (Governing Bodies; Participants; Executive Heads), the Board agreed to pay the costs for two retiree representatives to attend the annual meetings. It also approved a variety of measures aimed at making the Board's deliberations more efficient.

Comment: The U.S. may want to ask why the Board was nonresponsive to the General Assembly's request for proposals that would result in more equitable distribution of the seats on the Board. It could ask why the Board has spent several years and several hundred thousand dollars studying the issue, only to decide to maintain the status quo. The U.S. might want to propose, during the Fifth Committee's deliberations, that the General Assembly approve the 21-member option that was recommended by the Working Group but rejected by the Board.

¶8. Study of Personal Status for Pension Entitlements - What started out as a seemingly innocuous proposal by the Pension Fund Secretariat to collect information about the evolving issue of personal status in participating organizations grew into a lively and heated debate about same-sex marriages and domestic partnerships. The Board was informed by the Fund's Chief Executive Officer (Bernard Cocheme) that there had been significant changes in national legislation in several countries and that some member organizations had been reviewing the personal status of staff members for the determination of entitlements under their staff rules and regulations. Because such decisions had potential

consequences for the Pension Fund, the Secretariat proposed that it collect data and study the issue. Some Board Members expressed strong concerns about the Fund's engagement in such a sensitive and controversial issue, stating that the Fund had no business getting out in front of topics such as same-sex marriages. After substantial discussion, the Board

decided that employees' personal status for the purpose of entitlements was entirely up to the member organizations. The Board called on all member organizations to make sure that their staff members' personal status records "are maintained and verified on a fully current basis."

Comment: The U.S. may want to remain silent on this item, thereby accepting without question the Board's decision, which is consistent with decisions of the UN Secretariat and the UN General Assembly.

¶9. Internal audit arrangements - The controversy over access to the Fund's internal audit reports provided a lively few hours of heated discussion, including a threat by the CEO to resign his post if the audit issue was not resolved satisfactorily. Following a report from the OIOS auditors (via video from New York) who serve as the internal auditors for the Pension Fund, the CEO of the Fund expressed his concerns about the possible impact on the Fund of the General Assembly's decision in 2004 to allow member states' access to OIOS audit reports. Specifically, the CEO said he was opposed to this access provision because the Fund's internal auditors report to him and not to the General Assembly. The temperature in the meeting room rose several degrees when I asked about the status of the recommendations contained in a recent OIOS investigation of allegations of conflict of interest related to Pension Fund procurement. The CEO said he was "stunned" that a member state (in this case, the United States) had obtained access to a confidential investigation that was not yet completed. He added that he would quit as CEO if such a practice continued. While I responded that the report in question was not a draft and that the U.S. saw the access as critical for improved transparency, the CEO was successful in stirring up support for his alarmist position. Some Board members (primarily those representing Participants) agreed with the CEO and recommended that the Fund replace OIOS with its own internal auditors. After things calmed down a bit, the Board agreed that the Audit Committee should monitor the internal audit arrangements for the Fund as a matter of priority.

Comment: The U.S. may want to emphasize the importance of effective oversight of the large and growing UN Pension Fund and reiterate that the General Assembly has primary authority over budget and other issues related to the Fund. In the interest of transparency, it was therefore appropriate that Member States have full and adequate access to audit and oversight information.

¶10. Possible new member organizations - The Board considered the applications of the International Organization for Migration (IOM) and the International Commission for the Conversation of Atlantic Tunas (ICCAT) to become members of the Pension Fund. It decided to recommend to the General Assembly that IOM be admitted but concluded that ICCAT did not meet the terms of membership because, among other things, the Commission's governing body had not authorized the Executive Secretary submit an application or to make the required changes to its own staff regulations and salary scales.

Comment: The U.S. may want to express satisfaction with the Board's decision on IOM and signal its readiness to approve IOM membership in the Pension Board. It may also want to highlight the importance for other potential members to strictly follow the rules that apply to those considering membership.

¶11. Note: As a member of the UN Local Pension Committee in New York elected by the General Assembly, I attended the meeting and participated fully in the discussions. I took a strong interest in the issue of the size and composition of the Board, having served on the Working Group that recommended a reduction in the Board's membership (to 21). I also intervened frequently in discussions of the Fund's audit arrangements and the decision to create an Audit Committee. I was subsequently appointed to a three-year term as a member of the new Committee. Being less senior than other

representatives of the General Assembly on the Board, however, I was designated an "alternate" member and therefore was not authorized to vote.
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